UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF GEORGIA
ATLANTA DIVISION

In re:	)	Chapter 7
	)	
SON R. SHARMA and SANTOSH K. SHARMA	)	Case No. 03-68468
	)	
Debtors	)	Judge Diehl
	)	
NEIL C. GORDON, Trustee	)	Adversary Proceeding
	)	
Plaintiff,	)	No. 04-06438
	)	
vs.	)	
	)	
ABN AMRO MORTGAGE GROUP, INC.	)	
	)	
Defendant	)	

ORDER GRANTING DEFENDANT'S MOTION
FOR SUMMARY JUDGMENT AND DENYING
PLAINTIFF'S MOTION FOR SUMMARY JUDGMENT

This matter is before the Court on the cross motions for summary judgment filed by Plaintiff Neil C. Gordon, Chapter 7 Trustee for the Estate of Santosh K. Sharma ("Trustee") and Defendant ABN Amro Mortgage Group, Inc. ("Defendant"). Oral argument on the motions was held on July 21, 2005 and after considering all the materials submitted[1] and the arguments of the

[1]Plaintiff's Motion for Summary Judgment filed by Neil C. Gordon (A.P. Docket #12); Memorandum of Law in Support of Plaintiff's Motion for Summary Judgment (A.P. Docket #13); Response to Motion (Defendant's Reply to Plaintiff's Motion for Summary Judgment and Defendant's Cross-Motion for Summary Judgment, Reply brief of Defendant in Opposition to Plaintiff's Motion for Summary Judgment and in Support of Defendant's Cross-Motion for Summary Judgment and Affidavit, Attachments to Affidavit) (A.P. Docket #17); Statement of

parties, Defendant's Motion for Summary Judgment will be GRANTED and Trustee's Motion for Summary Judgment will be DENIED. A separate judgment will be entered.

FACTS

The material facts are undisputed. On June 18, 2003 ("the petition date"), Debtor Santosh K. Sharma filed a joint Chapter 7 case with her spouse, Som R. Sharma (Case No. 03-68468). Trustee was appointed interim trustee and became the permanent case trustee on July 23, 2003 at the conclusion of the meeting of creditors held pursuant to 11 U.S.C.§ 341(a). As of the petition date, Debtor Santosh K. Sharma owned an undivided one-half interest in a residence located at 1960 Sugar Lake Court, Lawrenceville, Georgia 30043-5050. The remaining one-half interest was owned by a non-debtor, Sanjiv Gupta.

On May 20, 2003, Debtor Santosh Sharma and non-debtor Gupta refinanced the debt secured by this residence. The new loan was obtained from Defendant and was in the amount of $225,000. The loan was to be secured by a first priority deed to secure debt and the proceeds from the loan were used to pay off the existing first and second liens on the residence: Union Planter's Bank ($194,110.06) and Atlantic States Bank ($27,860.85). The Union Planter's Bank lien secured debt owed by Debtor; the Atlantic States Bank lien secured debt owed by Gupta.

Undisputed Facts Offered in Support of Plaintiff's Motion for Summary Judgement (A.P. Docket #18); Reply to Response (Plaintiff's Reply to Defendant's Reply (sic) to Plaintiff's Motion for Summary Judgment and Defendant's Cross Motion for Summary Judgment) (A.P. Docket #19); Statement of Undisputed Facts (Plaintiff's Reply to Defendant's Statement of Material Facts as to Which There is no Genuine Issue) (A.P. Docket #20); Response to Motion (Defendant's Reply to Plaintiff's Statement of Material Facts Not in Dispute Offered in Support of Plaintiff's Motion for Summary Judgment) (A.P. Docket #21); Supplemental Brief for Defendant's Cross-Motion for Summary Judgment) (A.P. Docket #26); Supplemental Memorandum of Points and Authorities in Support of Cross-Motion for Summary Judgment and in Opposition to Plaintiff's Motion for Summary Judgment) (A.P. Docket #29).

The security deed to Defendant was executed by Debtor and Gupta at the closing on May 20, 2003.

The three day rescission period for the loan expired at midnight on Friday, May 23, 2003, the Friday preceding the Memorial Day holiday. Disbursements were made to Union Planter's Bank and Atlantic States Bank by checks which were sent by Federal Express on the next business day after the rescission period, Tuesday, May 27, 2003. On May 28, 2003, the closing attorney sent the security deed in favor of Defendant to The Gwinnett County Clerk of Superior Court together with checks for the recording fee and intangibles tax which were due.[2]

The date of the receipt of the security deed by Gwinnett County for recording is not in evidence. Defendant's security deed was recorded on June 10, 2003. At the time it was recorded, the security deeds of Union Planter's Bank and Atlantic States Bank were still of record in Gwinnett County. On the Petition Date, there were three security deeds of record on Debtors' property. On June 23, 2003, the cancellation of Union Planter's Bank security deed was recorded and on June 26, 2003, the cancellation of Atlantic States Bank's security deed was recorded.

LEGAL ISSUES

The Trustee commenced this adversary proceeding on July 29, 2004, seeking to avoid as a preference the transfer by Debtor to Defendant of the security interest in her residence. The Trustee's action is premised on 11 U.S.C.§ 547(b) which provides:

> Except as provided in subsection (c) of this section, the trustee may avoid

[2]The method by which the security deed was transmitted is not in evidence. The transmittal "letter" does not indicate whether it was hand delivered, mailed, sent by courier or otherwise.

any transfer of an interest of the debtor in property–

(1) to or for the benefit of a creditor;
(2) for or on account of an antecedent debt owed by the debtor before such transfer was made;
(3) made while the debtor was insolvent;
(4) made –

(A) on or within 90 days before the date of the filing of the petition;

. . . .

(5) that enables such creditor to receive more than such creditor would receive if –

(A) the case were a case under chapter 7 of this title;
(B) the transfer had not been made; and
(C) such creditor received payment of such debt to the extent provided by the provisions of this title.

Critical to Trustee's complaint is the determination of when the transfer occurred between Debtor and Defendant. Transfers of interests in real property are governed by section 547(e), which provides that

(1) For purposes of this section –

(A) a transfer of real property other than fixtures, but including the interest of a seller or purchaser under a contract for the sale of real property, is perfected when a bona fide purchaser of such property from the debtor against whom applicable law permits such transfer to be perfected cannot acquire an interest that is superior to the interest of the transferee; ....

(2) For purposes of this section, except as provided in paragraph (3) of this subsection, a transfer is made —

(A) at the time such transfer takes effect between the transferor and the transferee, if such transfer is perfected at, or within 10 days after, such time, except as provided in subsection (c)(3)(B);[3]

[3]Section 547(c)(3) exempts purchase money security interests from Trustee's avoidance powers under § 547(b) where the security interest is perfected within 20 days after the debtor receives possession. Some courts have held that § 547(c)(3) is inapplicable in the refinancing context. *Patterson v. Irwin Mortg. Corp. (In re Patterson)*, 330 B.R. 631, 2005 Bankr. LEXIS 1850 (Bankr. E.D. Tenn. 2005) (§ 547(c)(3) inapplicable in refinancing context); *Palmer v. Key Bank USA (In re Conley)*, 318 B.R. 812, 816-17 (Bankr. E.D. Ky. 2004) (Section 547(c)(3) was irrelevant to refinancing loan, as it "applies only to loans made to enable the debtor to acquire the collateral."); *Sticka v. U-Lane-O Credit Union (In re McKay)*, 1999 Bankr. LEXIS 1908,

(B) at the time such transfer is perfected, if such transfer is perfected after such 10 days; or
(C) immediately before the date of the filing of the petition, if such transfer is not perfected at the later of–
(i) the commencement of the case; or
(ii)10 days after such transfer takes effect between the transferor and the transferee.
(3) For purposes of this section, a transfer is not made until the debtor has acquired rights in the property transferred.

In essence, Trustee argues that the transfer by Debtor of a security interest in the residence took place on May 20, 2003 but was not perfected until the security deed was recorded on June 10, 2003,[4] beyond the ten day period allowed by 11 U.S.C. § 547(e)(2)(A). Therefore, the transfer is deemed to have occurred on the recording date under 11 U.S.C. § 547(e)(2)(B). Thus, it is a payment on an antecedent debt since the debt was created when the loan was funded.

Defendant raises a number of defenses, including contemporaneous exchange (11 U.S.C. § 547(c)(1)) and equitable subrogation under Georgia law. Both of those defenses are grounded in a determination that the transfer of the security interest to Defendant occurred on May 27, 2003 (loan funding), the same time that the debt was created.

SUMMARY JUDGMENT STANDARD

Both parties move for summary judgment. Pursuant to Fed. R. Civ. P. 56(c), made applicable by Fed. R. Bankr. P. 7056, a party moving for summary judgment is entitled to prevail

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6 (Bankr. D. Or. Feb. 1, 1999)(automobile refinancing loan not governed by § 547(c)(3)).

[4]The date on which a security deed becomes effective against a bona fide purchaser is the date on which it is *filed*, not the date on which it is *recorded.* O.C.G.A. § 44-2-2(b); Pindar's Georgia Real Estate Law and Procedure, § 21-18, pp. 601-02 (6th ed. 2004). No evidence was introduced as to the filing date, although Defendant did show that the security deed was sent to Gwinnett County on May 28, 2003 although the deed was not recorded until June 10, 2003.

if "the pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits, if any, show that there is no genuine issue as to any material fact and that the moving party is entitled to judgment as a matter of law." *Celotex Corp. v. Catrett*, 477 U.S. 317, 322 (1986) (*quoting* Fed. R. Civ. P 56(c)). The parties do not dispute the material facts.

DISCUSSION OF LEGAL ISSUES

Georgia law governs this action. A determination of when the transfer of the security interest occurred under 11 U.S.C. § 547(e)(1)(A) therefore turns on when "a bona fide purchaser of such property from the debtor against whom applicable law permits such transfer to be perfected cannot acquire an interest that is superior to the interest of the transferee." Stated another way, if a bona fide purchaser (BFP) at the petition date could obtain title to the real estate and not be subject to Defendant's security deed, the transfer was not perfected and the Trustee wins. If the BFP could not have taken free of the security interest, Defendant wins.

At all points in time from May 20, 2003 until after this bankruptcy case was filed, there were one or more security deeds of record against Debtor's residence. At the time that Defendant's security deed was filed on June 10, 2003, the security deeds of Union Planter's Bank and Atlantic States Bank were still of record. Thus, any party acquiring the real estate between May 20, 2003 and June 10, 2003 who searched the title to the property would have found two security deeds of record. Under Georgia's recording statutes, a party acquiring title is charged with constructive knowledge of what a search of the title records would reveal.

> The general rule in Georgia is "that when property is transferred to one for value, the transferee not having actual notice of any lien against the property, and no lien being recorded, he takes the property free of the lien. But under our recording statutes, if the lien is properly recorded so as to give constructive notice of its

> existence to all would be transferees, then the transferee has notice of the lien, and the transferred property in his possession is subject to the lien."*Kilgore v. Buice,* 229 Ga. 445, 448, 192 S.E.2d 256 (1972).

Matter of Fulton Air Service, 254 Ga. 649, 650, 333 S.E.2d 581, 582-83 (1985).

Under the facts of this case, a bona fide purchaser would be charged with constructive knowledge of the two recorded deeds. However, the loans which those security deeds secured had been paid in full and Defendant's security deed had not yet been filed. The Trustee argues that since the underlying loans had already been satisfied, these security deeds were of no further force and effect and therefore even if a BFP took subject to them, the BFP did not take subject to Defendant's unrecorded lien which is all that matters here. To fill this gap, the Court must examine the Georgia doctrine of equitable subrogation.

Equitable subrogation is a precept of Georgia real estate law which has its origins in a 1898 Georgia Supreme Court case, *Merchants' & Mechanics' Bank v. Tillman*, 106 Ga. 55, 31 S.E. 794 (1898). Essentially, the doctrine provides that where the intent of the parties is to substitute one creditor's rights for the rights of the creditor that is being paid, the second creditor steps into the shoes of the first creditor as to priority and perfection. As the Georgia Supreme Court stated

> [t]his rule, it will be observed, distinctly recognizes the right of one parting with his money to expressly stipulate that he shall be substituted for and occupy the position of another, whose rights in the premises he seeks to acquire; and all the authorities above cited agree that a special contract of this nature, whenever it contemplates what is commonly known as "conventional subrogation," is perfectly legitimate and enforceable. . . . Thus, "one who advances money to pay off an incumbrance, upon an agreement with the debtor that the security shall be assigned to him, or a new one given to him, will be subrogated to the rights of the incumbrancer; and if the new security turns out to be

> defective, he will be substituted to the benefit of the prior incumbrance, unless the superior or equal equities of others would be prejudiced thereby." 24 Am. & Eng. Enc. Law, 292-294. The theory upon which a court of equity proceeds, in an instance such as that just cited, would seem to be that. Where one expressly contracts with a debtor for security which will secure, the fact that he does not actually get it is immaterial, unless equal or superior rights of third persons have intervened; for, as against the debtor himself and all parties whose rights will not be injuriously affected, the contract between him and the person in good faith advancing his money should be given effect, and consequently that will be considered done which ought to have been done. In other words, such person will be deemed to occupy the situation in which he would have been placed had the contract been executed in strict conformity to the express agreement between the parties, and his rights will be measured accordingly, whenever protection of him does not also involve a disregard of the rights, legal or equitable, of others concerned.

Tillman at 56-57.

The facts of *Tillman* involved a payoff of a first priority security deed by a new lender where a second priority security deed had also been filed. The agreement between the debtor and the new lender was that the new lender would take the place and priority of the existing first priority deed. The old first lender satisfied its security deed of record and Tillman, the new lender, without examining title, filed a new deed. The existing second lender (Merchants') argued that it was now first priority since Tillman had constructive notice of Merchants' deed and because Tillman could have taken an assignment of the existing first deed and did not. The Georgia Supreme Court rejected those arguments and held in favor of Tillman, because there was no "culpable negligence" on the part of Tillman. *Id. at 60-61.*

The Georgia Supreme Court has continued to apply this principle, most recently in *Davis v. Johnson*, 241 Ga. 436, 246 S.E.2d 297 (1978). That case involved an intervening judgment lien. Gwinnett County Bank had a purchase money security deed from Johnson. Johnson

contracted to sell the property to Davis in June and in September, Davis borrowed funds from Gwinnett County Bank to pay the purchase price. The security deed given by Davis included a provision that Davis had absolute title and there were no other liens on the property. Unknown to Davis or the Bank, a judgment creditor of Johnson had recorded a judgment lien in July. When Gwinnett County Bank's security deed from Johnson was cancelled in December, the lien creditor, asserting that it held the first priority interest, sought to foreclose its lien. The Gwinnett County Bank raised the issue of equitable subrogation and sought to reinstate its cancelled security deed. The trial court held for the judgment creditor and the Georgia Supreme Court reversed and held:

> Although it may seem somewhat anomalous to allow someone to be subrogated to his own rights, we believe that the use of the subrogation doctrine under the circumstances of this case is entirely justified. As we stated in *Cornelia Bank v. First Natal. Bank,* 170 Ga. 747, 750 (154 SE 234)(1930), "Subrogation . . . is of equitable origin and benevolence. It is founded upon the dictates of refined justice. Its basis is the doing of complete, essential, and perfect justice between all the parties, without regard to form, and its object is the prevention of injustice. . . The courts incline rather to extend than restrict the principle. The doctrine has been steadily growing and expanding in importance, and becoming general in its application to various subjects and classes of persons, the principle being modified to meet the circumstances of cases as they have arisen." *Southern R. Co. v. Overnite Transp. Co.,* 223 Ga. 825, 830 (158 SE2d 387)(1967).

241 Ga. at 439.

A dissent in the *Davis* case relied on the fact that equity should not intervene where the Bank could have protected itself by examining the title. Even under the reasoning of the dissent, the doctrine of equitable subrogation appears to be applicable here. There is no evidence of any negligence by Defendant – the security deed was sent to the County for recording on the day following the disbursement of funds – and certainly no evidence of "culpable negligence."

Thus, because Defendant was equitably subrogated to the rights of the prior lenders when it advanced the funds to pay off those debts, a BFP could not get ahead of Defendant in priority since a record search would have revealed the existence of those liens. The Trustee can have no greater rights than those of the BFP under Section 547(e) since the transfer of the interest to Defendant occurred at the time the loan was funded and the prior lienholders were paid off. A recent case in this district has applied the principles of equitable subrogation in a slightly different factual context. In *Gordon v. NovaStar Mortg. (In re Hedrick)*, 2005 Bankr. LEXIS 1923 (Bankr.N.D. Ga. August 31, 2005), Judge Massey held that a transfer of a security deed was protected by principles of equitable subrogation to bring it outside the ninety day preference period of Section 547. The reasoning of *In re Hedrick* applies as well to this case.

The Trustee argues that equitable subrogation is inapplicable and cites several cases where courts declined to apply the principle in preference cases. These cases are distinguishable. First, none of the cases deals with Georgia's law of equitable subrogation. The Trustee relies on cases concerning Michigan's law on equitable subrogation, which has preconditions to its applicability which are not required under Georgia law. Under Michigan law, equitable subrogation is a doctrine "depending on no contract or privity, and proper to apply whenever persons other than mere volunteers pay a debt or demand which in equity and good conscience should have been satisfied by another." *Stroh v. O'Hearn*, 176 Mich. 164, 142 N.W. 865 (1913). Michigan courts have specifically excluded refinancing lenders from eligibility to be subrogated to the priority of previous security interests. *Flagstar Bank v. Charter One Bank*, 2005 Mich. App. LEXIS 2094 (Mich. Ct. App. Aug. 25, 2005) (unpublished opinion) (Refinancing lender was a volunteer where it was under no "legal or equitable duty" to the borrowers to undertake the

refinancing, and therefor could not be equitably subrogated to the priority of the older mortgagee).

Georgia's equitable subrogation doctrine has no such "volunteer" bar. See *Merchants' & Mechanics' Bank v. Tillman*. The Trustee argues that Georgia law does have such a "volunteer" limitation, citing *Lee v. Arlington Peanut Co.*, 176 Ga. 816, 169 S.E. 1 (1933). However, *Lee* is distinguishable. *Lee* applied Georgia's law of legal subrogation, and held that a mortgagee, who, without the knowledge or agreement of the mortgagor, paid third party liens against the mortgagor was not entitled to subrogation where the mortgagee was under no obligation to pay the mortgagor's debts. *Id*. In this case, Defendant agreed with Debtor to discharge the prior indebtedness and to receive a first priority security deed in exchange. Even under *Lee*, Defendant was not a "volunteer" as it was obligated to pay both of the prior lenders as part of the refinancing. *See Lee* at 819 ("Any one who is under no obligation or liability to pay the debt is a stranger, and, if he pays the debt, a mere volunteer.")(quoting *Aetna Life Ins. Co. v. Middleport*, 124 U.S. 534, 550 (1888)). To hold that Georgia's equitable subrogation doctrine excludes lenders who advance money specifically to pay prior lien holders as "volunteers" would effectively overturn the holding of *Tillman.* This court declines to do so, especially in light of the fact that *Davis*, decided after *Lee*, imposed no such "volunteer" restriction on the application of Georgia's equitable subrogation doctrine. *See Davis v. Johnson*, 241 Ga. 436.

Furthermore, the Trustee's reliance on *Boyd v. Superior Bank FSB (In re Lewis)*, an unpublished opinion of the district court applying Michigan law,[5] is not compelling. The opinion

[5] 270 B.R. 215, 217 (W.D. Mich. 2001) aff'd *Boyd v. Superior Bank F.S.B. (In re Lewis),* Case No. 1:02-CV-31, Ch. 7 ST 00-03660, Adv. No. 00-88404 (W.D. Mich. 2001).

of the bankruptcy court which the district court was reviewing, although controlled by Michigan law, sought to impose a further limitation on equitable subrogation found in Missouri law. 270 B.R. at 217. The bankruptcy court stated that equitable subrogation was applicable to only "extreme cases bordering on, if not reaching the level of fraud." *Lewis* at 217 (citing *Rouse v. Chase Manhattan Bank, USA*, *NA (In re Brown)*, 226 B.R. 39, 44 (Bankr. W.D. Mo. 1998)). The fraud limitation is part of Missouri law; Georgia law has no such limitation. *See Merchants' & Mechanics' Bank v. Tillman*, 106 Ga. 55. The district court, while noting that Missouri law was not applicable, found that controlling Michigan law also limited the applicability of equitable subrogation. Only Georgia law is applicable to this case, not the laws of any other state.[6]

At least one court has opined that an application of the doctrine of equitable subrogation to a preference action "directly circumvents Congressional intent that the exclusive meritorious defenses to a § 547(b) preference action are set forth in § 547(c)." *Guinn v. Irwin Mortg. Corp. (In re Patterson),* 330 B.R. 631, 2005 Bankr. LEXIS 1850, *26-27 (Bankr. E.D. Tenn. 2005). This is similar to the Trustee's argument that the application of equitable subrogation makes it impossible for the Trustee to prevail in refinancing cases such as this. However, under Georgia law, the application of the preference statute, particularly § 547(e) requires the court to look at state law to determine when a transfer is made for purposes of the preference statute. If the Bankruptcy Code mandates the application of state law and state law requires the application of

[6] State equitable subrogation doctrines are not fungible. In fact, Georgia's law of equitable subrogation is very forgiving in comparison to the other, more limited state doctrines described above. Under Georgia law, a party may be entitled to equitable subrogation in the absence of "culpable neglect" on its part. *Tillman*, 106 Ga. at 61. Even such a glaring oversight as failure of a lender to investigate a title for properly recorded liens does not amount to "culpable neglect." *See Id*; *Davis v. Johnson*, 241 Ga. 436.

equitable subrogation, it certainly cannot be said to circumvent Congressional intent to apply it.

Having determined that the transfer of the security deed from Debtor to Defendant was perfected on May 27, 2003 because no BFP could acquire an interest superior to that of Defendant after that date, the transaction qualifies as a "contemporaneous exchange for new value" and is excepted from avoidance under 11 U.S.C. § 547(c)(1).

The Defendant also raises as a defense the doctrine of "earmarking." Earmarking is the concept that a preference cannot occur unless the debtor has an interest in the property transferred. Thus, if A gives the debtor funds for the express purpose of paying a debt owed to B, no preference results because the debtor was a mere conduit and had no interest in the property transferred. Earmarking has no applicability here because the transfer which the Trustee seeks to avoid is not the transfer of the funds but the transfer of a security interest by the Debtor.

For these reason, it is

ORDERED that Defendant's Motion for Summary Judgment is **GRANTED** and Plaintiff's Motion for Summary Judgment is **DENIED**.

This _____ day of October, 2005.

_____
Mary Grace Diehl
United States Bankruptcy Judge